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Louisiana State University School of Medicine in New Orleans Faculty Group Practice d/b/a LSU Healthcare Network and Subsidiaries

Management's Discussion and Analysis, Consolidated Financial Statements as of and for the Years Ended June 30, 2006 and 2005, and Independent Auditors' Report

Under provisions of state law, this report is a public document. A copy of the report has been submitted to the entity and other appropriate public officials. The report is available for public inspection at the Baton Rouge office of the Legislative Auditor and, where appropriate, at the office of the parish clerk of court.

Release Date 1-24-07

LSU HEALTHCARE NETWORK AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Louisiana State University School of Medicine in
New Orleans Faculty Group Practice:

We have audited the accompanying consolidated balance sheets of the Louisiana State University School of Medicine in New Orleans Faculty Group Practice d/b/a LSU Healthcare Network and subsidiaries (a Louisiana non-profit corporation) ("LSUHN") as of June 30, 2006 and 2005, and the related consolidated statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the LSUHN's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of LSUHN's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of LSUHN as of June 30, 2006 and 2005, and the consolidated changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's discussion and analysis on pages 3 through 13 is not a required part of the basic consolidated financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of LSUHN's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and we do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 30, 2006, on our consideration of LSUHN's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte & Touche LLP

November 30, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Louisiana State University School of Medicine in New Orleans Faculty Group Practice *d/b/a LSU Healthcare Network's ("LSUHN") annual financial report presents management's discussion and* analysis of financial performance during the fiscal year ended June 30, 2006. It should be read in conjunction with the consolidated financial statements in this report.

FINANCIAL HIGHLIGHTS

Hurricane Katrina

On August 29, 2005 Hurricane Katrina struck the Greater New Orleans area causing widespread destruction that significantly impacted LSUHN. Business activity in the New Orleans area substantially came to a halt in September 2005, while Lafayette and Baton Rouge clinics experienced more moderate interruptions. As a result financial results for the year ended June 30, 2006 vary significantly from the year ended June 30, 2005 and from budget estimates. The results in this discussion and analysis should be viewed with the impact of Katrina in mind.

General

LSUHN reflected a change in net assets of $(1,997,499) for the year ended June 30, 2006, compared to a change in net assets of $943,948 for the year ended June 30, 2005.

- Patient service revenue net of contractual adjustments and allowances and bad debt was about $19.7 million lower in fiscal year 2006 than fiscal year 2005.
- Net increase of $0.4 million in capitated revenue in excess of claims paid.
- Personnel and leased non faculty expense decreased $2.6 million for the year.
- Physician compensation and enhancement fund expenses decreased over $4.7 million.
- General and administrative expenses decreased $3.0 million.
- A decrease in medical supplies expense of $1.7 million and the return of a donation to LSU Alumni Association of $2.0 million accounts for most of the remaining year-to-year variance.

Total assets at June 30, 2006 increased $2.4 million from June 30, 2005. Cash increased $6.5 million while accounts receivable decreased $1.4 million, and short term investments and other assets decreased $2.5 million. Current assets exceed current liabilities by $7.6 million, and LSUHN has a current ratio of 1.44.

GE/IDX Partnership

On March 22, 2004 LSUHN entered into a ten year agreement with IDX Information Systems Corporation ("IDX"), headquartered in Burlington, Vermont. Under the agreement, IDX will provide LSUHN all of the functionality of its Flowcast software, the Allscripts hand-held charge capture and coding software, full back-office staffing and management as well as other onsite training and support and IT support and hosting. After an initial planning period, the contract commenced on June 1, 2004. In August of 2005 IDX was acquired by GE Healthcare. The acquisition did not change the terms or structure of the agreement with LSUHN.

The timeline of second year projects was disrupted by the effects of Katrina. The rollout of the Allscripts charge capture product was halted and the system "reinstall" was delayed until September 2006. The system reinstall is a process whereby activity in the current system is cutoff as of a certain date, and activity is resumed in the most current software release with activity for services rendered from the cutoff date forward.

During fiscal year 2007 the focus of the GE/IDX effort will be on reducing charge lag days, producing cleaner claims reducing accounts receivable days and increasing the net collection rate.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of four components – the Management's Discussion and Analysis of Financial Condition and Operating Results (this section), the Independent Auditors' Report, the Consolidated Financial Statements, and the Auditors' Report on Compliance and on Internal Control over Financial Reporting.

The *Consolidated Financial Statements* of LSU Healthcare Network and Subsidiaries report the consolidated financial position of LSUHN and the consolidated results of its operations and its cash flows. The consolidated financial statements are prepared on the accrual basis of accounting. These statements offer short-term and long-term financial information about LSUHN's activities.

The *Consolidated Balance Sheets* include all of LSUHN's and its Subsidiaries' assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to LSUHN's creditors (liabilities) for both the current year and the prior year. They also provide the basis for evaluating the capital structure of LSUHN and assessing the liquidity and financial flexibility of LSUHN.

All of the current and prior year's revenues and expenses are accounted for in the *Consolidated Statements of Revenues, Expenses and Changes in Net Assets*. These statements measure the performance of LSUHN's operations over the past two years and can be used to determine whether LSUHN has been able to recover all of its costs through its patient service revenue and other revenue sources.

The primary purpose of the *Consolidated Statements of Cash Flows* is to provide information about LSUHN's cash from operations, investing, and financing activities. The cash flow statement outlines where the cash comes from, what the cash is used for, and the change in the cash balance during the reporting period.

The annual report also includes *Notes to the Consolidated Financial Statements* that are essential to gain a full understanding of the data provided in the consolidated financial statements. The notes to the consolidated financial statements can be found immediately following the basic financial statements in this report.

FINANCIAL ANALYSIS OF THE HEALTHCARE NETWORK

The consolidated balance sheets and the consolidated statements of revenues, expenses and changes in net assets report information about the practice's activities. These two statements report the net assets of LSUHN and the changes in them. Increases or improvements, as well as decreases or declines in the net assets, are one indicator of the financial state of the practice. Other non-financial factors that should also be considered include changes in economic conditions, changes in population patterns (including uninsured and working poor) and new or changed government legislation.

Condensed Consolidated Balance Sheets
(In thousands)

	Fiscal Year 2006	Fiscal Year 2005	Dollar Change	Total % Change
Current and other assets	$ 25,204	$ 22,547	$ 2,657	12 %
Capital assets	1,230	1,500	(270)	(18)%
Total assets	$ 26,434	$ 24,047	$ 2,387	10 %
Debt outstanding	$ 293	$ 423	$ (130)	(31)%
Other liabilities	17,164	12,649	4,515	36 %
Total liabilities	17,457	13,072	4,385	34 %
Invested in capital assets—net of related debt	937	1,377	(440)	(32)%
Unrestricted	8,040	9,598	(1,558)	(16)%
Total net assets	8,977	10,975	(1,998)	(18)%
Total liabilities and net assets	$ 26,434	$ 24,047	$ 2,387	10 %

Net assets decreased by $1,998,000 during the fiscal year ended June 30, 2006. Net income from operations decreased $8,344,357 from the prior fiscal year. This is partially offset by a decrease in other non-operating expenses net of revenue of $5,402,910 consisting primarily of decreased enhancement fund expense of $988,205 and the return of a donation made of $2 million (a $4 million swing) and a $476,000 insurance recovery for Katrina losses. The change in operating income reflects the decrease in net patient service revenue caused by Katrina.

The increase in total assets is attributable to an increase in cash which was partially offset by decreases in short-term investments, accounts receivable, inventory of drugs and medical supplies and capital assets.

The cash balance was positively impacted by the receipt of Medicaid funds paid out under a program called the Upper Payment Limit ("UPL") that the state of Louisiana participated in through its Department of Health and Hospitals ("DHH") and the federal government's Centers for Medicare and Medicaid Services ("CMS"). The UPL program pays the provider of Medicaid services at an "upper limit" determined by computing the average reimbursement rate which the physicians receive for the same services under contracts with private payors. This enhanced reimbursement became available to the faculty of the School of Medicine in New Orleans for services provided beginning April 1, 2005. The UPL payments of over $7.8 million for the period from April 1, 2005 through December 31, 2005 were received in June 2006 and are the primary reason for the year-to-year increase in the cash balance. Additionally, LSUHN made a $2 million donation to the LSU Alumni Association to finance the expansion of the learning center utilized by the medical students at LSUHSC. The Louisiana Legislative Auditor later questioned the propriety of the donation and although LSUHN disagrees with the Legislative Auditor's assessment, the donation was returned at the request of the Chancellor of LSUHSC.

Short-term investments decreased $2.3 million. At June 30, 2005 these funds were held in short-term investments by LSUHN's wholly owned subsidiary University Medical Group L.L.C. These investments were liquidated in fiscal year 2006 and paid to the parent as a dividend. Accounts receivable decreased as billing decreased after Katrina. The inventory of drugs primarily consisted of oncology drugs, and as of June

30, 2006, the oncology staff has substantially left the School of Medicine ("SOM"). As a result there is no current need to carry inventory for infusion patients resulting in the $222 thousand decrease in the inventory balance. Capital assets decreased nearly $270 thousand as certain assets and improvements were abandoned as a result of Katrina. An insurance claim for losses amounting to $476,000 was received in September 2006.

Total liabilities increased as increases in the liability for medical claims payable and the amount due to LSU Health Sciences Center ("LSUHSC") offset a decrease in accounts payable and accrued liabilities. The most significant increase was in the amount due to LSUHSC, which increased primarily due to the UPL payments received in June 2006.

Summary of Revenues, Expenses and Changes in Net Assets

The following table presents a summary of the practice's historical revenues and expenses for each of the fiscal years ended June 30, 2006 and 2005:

Condensed Statement of Revenues, Expenses and Changes in Net Assets
(In thousands)

	Fiscal Year 2006	Fiscal Year 2005
Net patient service revenue	$31,413	$51,107
Capitation revenue	24,029	15,474
Total operating revenues	55,442	66,581
Operating and administrative	32,930	43,945
Medical claims paid	20,147	11,996
Depreciation	658	589
Total operating expenses	53,735	56,530
Operating income	1,707	10,051
Nonoperating revenues (expenses):		
Medical school enhancement fund	(6,340)	(7,328)
Interest income, interest expense, other—net	2,635	(1,779)
Changes in net assets	(1,998)	944
Total net assets—beginning of year	10,975	10,031
Total net assets—end of year	$ 8,977	$ 10,975

During fiscal year 2006, the practice generated 57% of its total revenues from patient care with the other 43% being derived from capitation revenue from LSUHN's wholly owned subsidiary, University Medical Group, L.L.C. This represents a shift of 20% from patient care revenue to capitation revenue compared to fiscal year 2005. While Katrina severely impacted the New Orleans area, resulting in drastically lower patient care revenue, UMG was able to maintain most of its enrollment, and services were provided to evacuated enrollees through out-of-network providers.

LSUHN provides care to patients in the Louisiana public hospital system (Medical Center of Louisiana or "MCL") without regard to their ability to pay for those services. Because of substantially improved interfaces with the MCL system, LSUHN is able to enter free care charges into the system before they are adjusted out of revenues improving the practices ability to report the level of these services provided to the public. During the year ended June 30, 2006, charity charges entered into the billing system and adjusted off totaled over $35.5 million compared to $37.6 million during the year ended June 30, 2005. The year-to-year figure is largely unchanged even though the amount of free care provided in New Orleans declined significantly as a result of Katrina. Offsetting the New Orleans decline were increases in Lafayette and Baton Rouge that resulted from the improved data capture and a change in process in Baton Rouge. It is also likely that evacuees from New Orleans who sought residence in Lafayette and Baton Rouge contributed to the increase in free care at those locations. During all of fiscal year 2006, the Baton Rouge location input all charity services in the system, which input was not done in prior years.

The following table represents the relative percentage of gross charges billed for patient services by payor for the years ended June 30, 2006 and 2005:

	Fiscal Year 2006	**Fiscal Year 2005**
Medicare	12 %	15 %
Medicaid	28	31
HMO/PPO	21	21
Commercial	4	4
Contract	2	1
Self-pay	11	13
Radiology & Pathology (PBO)	-	1
LSUHN Surgery Center LLC	-	1
Free care/indigent	22	13
Total gross charges	100 %	100 %

OPERATING AND FINANCIAL PERFORMANCE

Katrina's impact was the major factor impacting operating and financial performance in fiscal year 2006. It led to a major restructuring of the staff and our clinic sites.

Because of the restricted access to the New Orleans metro region in September 2005, LSUHN's management team secured temporary administrative and clinical space in Baton Rouge. When the magnitude of the problem became clear, the team formulated a plan which included restructuring of the staff to match the new environment facing the practice. Emergency staff reductions took place in October 2005, and where appropriate, new positions were opened reflecting the expectations needed for the clinics to survive in their restructured mode. The net change was a 45% decrease in staff.

All clinical sites in the New Orleans region were initially closed. Several clinic sites were established in the Baton Rouge area that allowed some clinical activity to resume in September and October. Towards the end of fiscal year 2006 with the recovery and repopulation of New Orleans underway, activity in these Baton Rouge sites has been reduced and the sites have been closed subsequent to June 30, 2006.

Activity in New Orleans first resumed at Kenner Regional and Children's Hospital. Later, clinics were established at Touro Infirmary, the St. Thomas Clinic and East Jefferson General Hospital. In the spring of 2006 clinics were also opened in the Memorial Medical Center medical office building.

Clinical sites at Lindy Boggs, 2020 Gravier St. and the MCL main campus and University Hospital campuses were all closed due to extensive damage. The administrative offices at 1542 Tulane Ave. were also inaccessible. MCL and University remain closed, but trauma and clinical services are being provided at temporary facilities in New Orleans and the surrounding suburbs. The hospital and medical office building at Lindy Boggs remain closed. 2020 Gravier is being used by the SOM for administrative space, and LSUHN has moved its administrative offices to the Amoco building on Poydras Street. The University Hospital campus of MCL is reopened in November, 2006 with limited capacity.

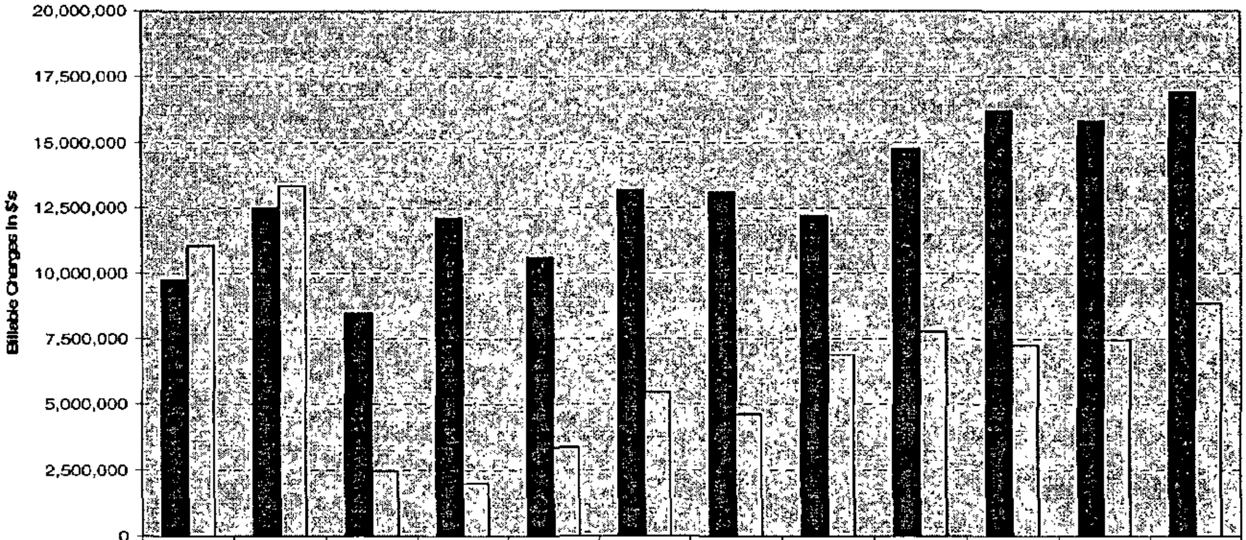
The following summarizes between 2006 and 2005, the practice's Statements of Revenue, Expenses and Changes in Net Assets:

- Revenue from patient services net of contractual allowances, adjustments and bad debt decreased 39% from 2005 to 2006.
  - The LSUHN Surgery Center LLC did not resume operations after the hurricane resulting in the loss of $850 thousand in net revenue compared to 2005.
- Non-physician personnel expense decreased $2.6 million or nearly 27%.
  - Reduction in staff related to Katrina.
  - The reduction in expenses is not exactly proportionate to the decrease in revenue because employees were retained into October and received severance packages while the negative impact on revenue from the storm was immediate in September.
- General and administrative expenses decreased by $3.0 million in 2006.
- Medical supplies/drugs expense decreased $1.7 million.
- Medical claims paid increased due to an increase in capitation revenue from the Tenet Choices 65, Healthcare Select and New Orleans Choice programs that LSUHN participates in through its subsidiary University Medical Group, LLC.
- Payments for leased employees-faculty decreased $3.7 million.
- Enhancement Fund payments decreased nearly $1 million.
- LSUHN donated $2 million to the LSU Alumni Association in fiscal year 2005 for the purpose of expanding the Medical School's Learning Center. The donation was returned in fiscal year 2006 at the request of the Legislative Auditor.

After considering other net revenues and expenses, the practice realized a reduction in net assets of nearly $2 million in 2006 compared to $944 thousand in revenues over expenses in 2005.

The following chart and tables show the trend in billable charges, payments and the change in activity for the top forty physicians in LSUHN for the fiscal years 2006 and 2005:

LSU Healthcare Network
Billable Charges
FY 2005 and 2006
(Cash Basis)

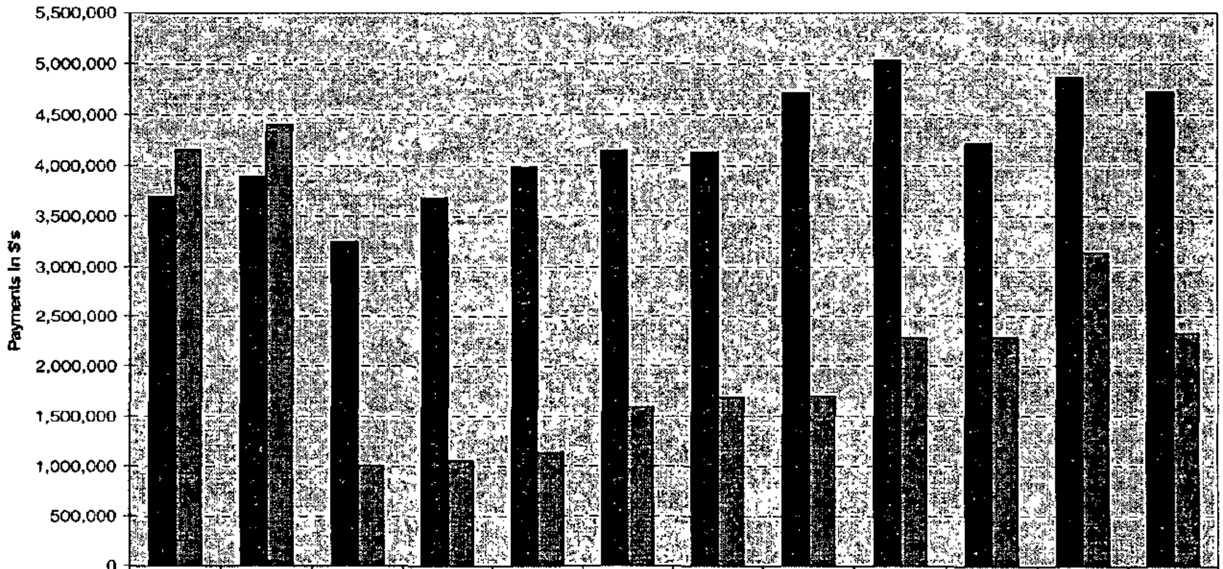


	July	August	September	October	November	December	January	February	March	April	May	June
2005	9,769,710	12,510,855	8,480,742	12,130,041	10,645,161	13,186,658	13,105,288	12,234,837	14,782,224	16,203,992	15,819,537	16,914,041
2006	11,055,499	13,358,769	2,463,369	2,023,961	3,379,675	5,456,884	4,627,175	6,888,976	7,759,313	7,237,291	7,454,073	8,864,233

Month

2005 2006

LSU Healthcare Network
Payments Posted
FY 2005 and 2006
(Cash Basis excluding UPL payments)



	July	August	September	October	November	December	January	February	March	April	May	June
2005	3,696,642	3,889,539	3,251,524	3,685,956	3,984,295	4,147,226	4,139,200	4,718,353	5,037,366	4,222,341	4,872,262	4,730,744
2006	4,161,775	4,402,308	1,012,001	1,058,850	1,143,768	1,595,628	1,690,180	1,705,002	2,289,466	2,290,914	3,140,936	2,333,000

Month

2005 2006

LSU Healthcare Network
Top 40 Physicians/Services
Fiscal Years 2006 and 2005
Sorted by 2005 Production

	Department	2005	2006	Difference	% Difference	Status
1	Medicine	1,861,233	852,472	(1,008,761)	-54.20%	Gone
2	Anesthesiology	1,619,762	468,638	(1,151,124)	-71.07%	Still with LSUHN
3	Pediatrics	1,554,560	511,706	(1,042,854)	-67.08%	Still with LSUHN
4	Surgery	1,460,696	979,026	(481,670)	-32.98%	Still with LSUHN
5	Pediatrics	1,454,192	869,569	(584,623)	-40.20%	Still with LSUHN
6	Pediatrics	1,399,364	578,885	(820,478)	-58.63%	Still with LSUHN
7	Anesthesiology	1,399,222	111,796	(1,287,426)	-92.01%	Gone
8	Pediatrics	1,371,997	559,560	(812,437)	-59.22%	Still with LSUHN
9	Anesthesiology	1,359,980	182,883	(1,177,097)	-86.55%	Still with LSUHN
10	Dermatology	1,351,665	241,815	(1,109,850)	-82.11%	Gone
11	Urology	1,345,284	308,684	(1,036,600)	-77.05%	Locum Tenens
12	Ambulatory Surgery Center	1,329,106	238,366	(1,090,740)	-82.07%	Closed
13	Radiology	1,304,063	875,167	(428,895)	-32.89%	Still with LSUHN
14	Medicine	1,303,238	172,619	(1,130,619)	-86.75%	Gone
15	Neurology	1,272,182	247,524	(1,024,657)	-80.54%	Still with LSUHN
16	Neurosurgery	1,235,084	614,046	(621,038)	-50.28%	Gone
17	Surgery	1,208,986	492,160	(716,826)	-59.29%	Still with LSUHN
18	Orthopaedics	1,194,288	725,683	(468,605)	-39.24%	Still with LSUHN
19	Ophthalmology	1,161,599	254,162	(907,438)	-78.12%	Gone
20	Neurosurgery	1,149,338	51,394	(1,097,944)	-95.53%	Gone
21	Pediatrics	1,135,577	548,663	(586,914)	-51.68%	Still with LSUHN
22	Ophthalmology	1,131,948	249,091	(882,857)	-77.99%	Still with LSUHN
23	Orthopaedics	1,130,385	620,444	(509,941)	-45.11%	Gone
24	Ob/Gyn	1,121,296	637,704	(483,592)	-43.13%	Still with LSUHN
25	Anesthesiology	1,104,758	385,791	(718,967)	-65.08%	Still with LSUHN
26	Radiology	1,076,219	301,173	(775,047)	-72.02%	Still with LSUHN
27	Anesthesiology	1,062,044	284,456	(777,588)	-73.22%	Still with LSUHN
28	Ophthalmology	1,043,838	290,425	(753,414)	-72.18%	Gone
29	Ob/Gyn	1,019,711	8,187	(1,011,524)	-99.20%	Gone
30	Surgery	1,013,434	1,168,714	155,280	15.32%	Still with LSUHN
31	Pediatrics	995,072	461,344	(533,729)	-53.64%	Still with LSUHN
32	Urology	986,768	252,953	(733,815)	-74.37%	Gone
33	Medicine	985,415	433,835	(551,581)	-55.97%	Still with LSUHN
34	Radiology	983,778	694,849	(288,929)	-29.37%	Still with LSUHN
35	Anesthesiology	974,706	222,516	(752,190)	-77.17%	Still with LSUHN
36	Pediatrics	968,111	320,229	(647,882)	-66.92%	Still with LSUHN
37	Anesthesiology	962,210	359,906	(602,304)	-62.60%	Still with LSUHN
38	*Surgery*	946,616	954,376	7,760	*0.82%*	*Still with LSUHN*
39	Medicine	937,118	397,574	(539,544)	-57.57%	Still with LSUHN
40	Medicine	917,755	660,051	(257,704)	-28.08%	Still with LSUHN
		47,834,804	18,590,442	(29,244,162)	-61.14%	

Katrina impacted the practice on several levels. First is the impact on the population in the city needing medical services, second is the number of faculty practicing with LSUHN and third the number of facilities available in which to provide services. Recent population studies show about one-half of the New Orleans population has returned. Population in the larger suburbs is generally near pre-Katrina levels while St. Bernard and Plaquemines parishes continue to be well below pre-storm levels. The practice has lost about one-third of its top forty producers and closed its ambulatory surgery facility. The charts and table above show that with this level of faculty and patients in New Orleans charges and payments for the entire practice have returned to about one-half of pre-storm levels as of June 30, 2006. Baton Rouge and Lafayette have generally experienced increased levels of charge volume, primarily as the result of some of the displaced New Orleans residents currently residing in those areas.

The majority of LSUHN's equipment and furniture was not directly impacted by the flood waters in New Orleans. However, the practice did lose its main phone system hardware, which was located on the first floor at 2020 Gravier St. Additionally, medical equipment and office furniture at the Uro-Gyn clinic on the first floor of Lindy Boggs Hospital was also flooded. LSUHN has filed an insurance claim for these items, and was reimbursed approximately $476,000 in September 2006.

LSUHN is also participating in the business interruption claim being pursued by the state of Louisiana. The state has engaged the firm of Alverez & Marsal ("A&M") to negotiate a settlement with the insurance carriers. At this time LSUHN and A&M are not able to predict with any certainty what settlement, if any, might be available to LSUHN as a result of interruption caused by Katrina.

PERFORMANCE AGAINST BUDGET

In comparing actual versus budgeted fiscal year 2006 results, the following is noted (in thousands):

	FY 2006 Actual	FY 2006 Budget	Variance Favorable (Unfavorable)
Revenues:			
Net patient service revenue	$31,413	$ 52,013	$ (20,600)
Capitation revenue	24,029	7,960	16,069
Total revenues	55,442	59,973	(4,531)
Operating expenses:			
Leased employees—faculty	14,622	18,367	3,745
Personnel—salaries and benefits	7,224	10,363	3,139
General and administrative	9,166	12,480	3,314
Medical supplies and drugs	1,918	3,298	1,380
Medical claims paid	20,147	5,721	(14,426)
Depreciation	658	637	(21)
Total operating expenses	53,735	50,866	(2,869)
Operating income	1,707	9,107	(7,400)
Other revenues (expenses)—net	(3,704)	(8,770)	5,066
Change in net assets	$ (1,997)	$ 337	$ (2,334)

- Overall patient service revenue net of contractual adjustments, allowances and bad debt expense were under budget by 40% in 2006.
- Personnel expense and general administrative were under budget by 28%.
- Leased faculty employee payments and Enhancement Fund payments were under budget by 18% and 13%, respectively.
- An unbudgeted return of the $2 million contribution to the LSU Alumni Association to help finance the expansion of the Learning Center that is utilized by the medical students at LSU Health Sciences Center resulted in a favorable variance in other income and expense.

Capital Assets Summary
(In thousands)

	Fiscal Year 2006	Fiscal Year 2005	Dollar Change	Total % Change
Office furniture and fixtures	$ 403	$ 1,076	$ (673)	(63)%
Computers and related equipment	991	1,423	(432)	(30)%
Medical equipment	1,306	1,592	(286)	(18)%
Leasehold improvements	69	129	(60)	(47)%
Subtotal	2,769	4,220	(1,451)	(34)%
Less accumulated depreciation	(1,539)	(2,720)	1,181	(43)%
Net capital assets	$ 1,230	$ 1,500	$ (270)	(18)%

A practice improvement fund of $1,040,000 has been established for fiscal year 2007. Proposed projects include:

- Establishment of a Hearing and Balance Center
- Improved medical records and transcription services
- Maintenance of information systems and phone infrastructure

SHORT-TERM DEBT

LSUHN's short-term debt consisted of a note payable to Chase (formerly Bank One) in the amount of $300,000 at June 30, 2005 and a note payable to Alcon Industries in the amount of $16,859 and $104,093 at June 30, 2006 and 2005, respectively. The Chase note payable was used by LSUHN's wholly owned subsidiary LSUHN Surgery Center ("Surgery Center") for working capital purposes and was paid in full and terminated in June 2006 in conjunction with the closing of the ASC. The Alcon note payable was used to purchase medical equipment at the Surgery Center. Subsequent to year end the equipment was returned and the balance was settled.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

LSUHN's Board and senior management considered many factors while developing the fiscal year 2007 budget, but the economic recovery of Southeast Louisiana was the single greatest factor. Hurricane Katrina forced the relocation of the Health Sciences Center, the practice and many of our patients. As a result the focus of fiscal year 2007 will be stabilizing and rebuilding the practice. The recovery of the city of New Orleans and the surrounding region will play a significant role in our success. The practice has already begun to expand satellites that sustained less damage and establish new sites in a reshaped market. Other important economic factors include:

- The success of the IDX project
- Strategic relationships with our hospital partners
- Government regulations, including HIPAA
- Potential changes in Medicare reimbursement
- Cost of drugs and supplies
- Turnover in University faculty

- Cost of technology
- Maintaining a qualified workforce

During fiscal year 2007, LSUHN will focus its efforts on consolidating its clinical practice in fewer sites in order to gain operational efficiencies and encourage cross-referrals within our own group practice. Additionally, the practice will focus on a few specific lines of service that take advantage of LSUHN's strengths and fill underserved areas within the market.

CONTACTING THE PRACTICE'S FINANCIAL MANAGER

This financial report is designed to provide our customers and creditors with a general overview of LSUHN's finances. If you have questions about this report or need additional financial information, please contact the Chief Financial Officer, LSU Healthcare Network, 1340 Poydras St., Suite 1640, New Orleans, LA 70112.

REPORT OF MANAGEMENT'S RESPONSIBILITY

The management of LSUHN is responsible for the preparation and integrity of the financial information presented in this report. The basic financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as promulgated by the Governmental Accounting Standards Board and the Financial Accounting Standards Board and include amounts based on judgments and estimates made by management. Management also prepares the other information included in the report and is responsible for its accuracy and consistency with the consolidated financial statements.

The consolidated financial statements have been audited by the independent accounting firm of Deloitte & Touche LLP, who was given unrestricted access to all financial records and related data, including the minutes of all meetings of the Board of Directors. The Board of Directors, through its Finance Committee (the "Committee"), provides oversight to the financial reporting process. Integral to this process is the Committee's review and discussion with management of the monthly financial statements and the external auditors for the annual consolidated financial statements.

LSUHN maintains a system of internal control over financial reporting, which is designed to provide reasonable assurance that transactions are executed as authorized and accurately recorded and that assets are properly safeguarded, and also provide reasonable assurance to our management and the Board of Directors regarding the reliability of our consolidated financial statements. The internal control system includes:

- A documented organizational structure and division of responsibility
- Established policies and procedures that are regularly communicated and that demand highly ethical conduct from all employees

LSUHN's Executive Committee and Finance Committee monitor the operations and internal control system and report findings and recommendations to management and the Board of Directors as appropriate. Corrective actions are taken to address control deficiencies and other opportunities for improvement as they are identified.

Louisiana State University School of Medicine in New Orleans Faculty Group Practice (d.b.a. LSU Healthcare Network)

Frank G. Opelka, M.D.
Chief Executive Officer

John Cazre, CPA
Chief Financial Officer

LSU HEALTHCARE NETWORK AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF JUNE 30, 2006 AND 2005

	2006	2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$13,750,651	$ 7,221,731
Short-term investments		2,300,000
Accounts receivable (net of contractual allowances and doubtful accounts of $44,279,353 in 2006 and $$58,297,262 in 2005)	11,094,200	12,453,643
Prepaid expenses	38,612	50,247
Inventory of drugs and medical supplies		222,574
Total current assets	24,883,463	22,248,195
CAPITAL ASSETS—Net	1,230,378	1,499,909
OTHER ASSETS	320,615	298,885
TOTAL	$26,434,456	$24,046,989
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	$ 1,462,991	$ 1,596,617
Liability for medical claims payable	1,961,318	1,763,196
Notes payable—current portion	16,859	337,509
Leases payable—current portion	55,804	13,128
Due to LSU Health Sciences Center	13,739,328	9,289,664
Total current liabilities	17,236,300	13,000,114
NOTES PAYABLE—Less current portion		66,584
LEASES PAYABLE—Less current portion	220,922	5,558
Total liabilities	17,457,222	13,072,256
NET ASSETS:		
Invested in capital assets—net of related debt	936,793	1,377,130
Unrestricted	8,040,441	9,597,603
Total net assets	8,977,234	10,974,733
TOTAL	$26,434,456	$24,046,989

See notes to consolidated financial statements.

LSU HEALTHCARE NETWORK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
REVENUES:		
Patient service revenue—net of contractual adjustments and allowances	$31,413,135	$51,107,867
Capitation revenue	24,029,248	15,473,633
Total revenues	55,442,383	66,581,500
OPERATING EXPENSES:		
Leased employees—faculty	14,622,623	18,328,244
Leased employees—non faculty	867,327	1,477,395
Personnel—salaries and benefits	6,356,708	8,378,726
General and administrative	9,165,647	12,155,153
Medical supplies	1,917,939	3,605,575
Medical claims expense	20,147,809	11,996,022
Depreciation	657,510	589,208
Total operating expenses	53,735,563	56,530,323
INCOME FROM OPERATIONS	1,706,820	10,051,177
OTHER REVENUES (EXPENSES):		
Medical School Enhancement Fund	(6,339,865)	(7,328,070)
Donations	2,000,000	(2,000,000)
Contributions	15,000	30,000
Interest income and other income and expenses	672,203	212,163
Interest expense	(51,657)	(21,322)
Total other revenues (expenses)	(3,704,319)	(9,107,229)
CHANGE IN NET ASSETS	(1,997,499)	943,948
NET ASSETS—Beginning of year	10,974,733	10,030,785
NET ASSETS—End of year	$ 8,977,234	$10,974,733

See notes to consolidated financial statements.

LSU HEALTHCARE NETWORK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from clinic operations	$ 35,620,980	$ 49,398,086
Cash received from capitation revenue	20,845,859	15,128,733
Cash payments for personnel	(7,363,331)	(9,916,666)
Cash payments for leased faculty	(7,495,034)	(17,982,697)
Cash payments for supplies and general and administrative	(11,313,134)	(15,610,811)
Cash payments for medical claims	(18,921,665)	(11,745,967)
Net cash provided by operating activities	11,373,675	9,270,678
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Cash payments for Enhancement Fund	(8,786,484)	(8,450,558)
Cash payments for Medical School expenses	(190,694)	
Cash payments for donation	2,000,000	(2,000,000)
Cash payment for deposits	(20,916)	(7,160)
Contributions received	18,050	30,000
Net cash used in noncapital financing activities	(6,980,044)	(10,427,718)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds from notes and leases payable	309,794	
Payments on notes and leases payable	(358,388)	(55,986)
Purchase of capital assets	(680,661)	(665,888)
Proceeds from sale of capital assets	72,000	
Interest payments	(49,740)	(19,176)
Net cash used in capital and relating financing activities	(706,995)	(741,050)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	542,284	224,563
Liquidation of/(Investment in) short-term investments	2,300,000	(2,300,000)
Net cash provided by (used in) investing activities	2,842,284	(2,075,437)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	6,528,920	(3,973,527)
CASH AND CASH EQUIVALENTS—Beginning of year	7,221,731	11,195,258
CASH AND CASH EQUIVALENTS—End of year	$ 13,750,651	$ 7,221,731
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Income from operations	$ 1,706,820	$ 10,051,177
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	657,510	589,208
Change in assets and liabilities:		
Increase (decrease) in accounts receivable—net	1,835,477	(2,226,364)
Decrease in prepaid expenses and other assets	11,635	14,835
Decrease in inventory of drugs and medical supplies	222,574	47,074
Increase (decrease) in accounts payable and other liabilities	64,497	450,759
Increase in due to LSU Health Sciences Center—personnel and other costs	6,875,162	343,989
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 11,373,675	$ 9,270,678

SUPPLEMENTAL SCHEDULE OF NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES—During fiscal year 2005, , LSUHN entered into a note payable of $120,900 for medical equipment.

See notes to consolidated financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity—Louisiana State University School of Medicine in New Orleans Faculty Group Practice d/b/a LSU Healthcare Network and Subsidiaries ("LSUHN"), a Louisiana non-profit corporation, assists the LSU Health Sciences Center ("LSUHSC") in carrying out its medical, educational, and research functions. LSUHN provides health care to the general public including, but not limited to, the delivery of physician medical services and other health care services to individuals. LSUHN receives compensation for these services from the Medicare and Medicaid programs, certain commercial insurance carriers, health maintenance organizations, preferred provider organizations and directly from patients.

LSUHN's activities include services provided in both the public hospitals and the private clinics serviced by LSUHSC. LSUHN and LSUHSC (through the Board of Supervisors of Louisiana State University and Agricultural and Mechanical College) have entered into Cooperative Endeavor and Operating Agreements that provide the two entities to work together on a mutually beneficial basis. The agreements delineate the obligations and responsibilities of both LSUHN and LSUHSC. Both parties have the right to terminate the Cooperative Endeavor Agreement with or without cause upon 60 days written notice. The agreements expired October 31, 2005, and have been renewed on a month-to-month basis.

Basis of Accounting—The financial statements of LSUHN have been prepared using the proprietary fund method of accounting whereby revenues and expenses are recognized on the accrual basis of accounting and, accordingly, reflect all significant receivables, payables and other liabilities.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting/or Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the LSUHN has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board ("FASB") except those that conflict with a GASB pronouncement, including those issued after November 30, 1989.

Consolidation—The activity of the following entities that are controlled by LSUHN is included in these financial statements on a consolidated basis:

University Medical Group, LLC—LSUHN is the sole member of University Medical Group, LLC ("UMG"). UMG indirectly contracts with health maintenance organizations and other third-party payors under capitated arrangements to provide physician health care services to members who select UMG primary care physicians. UMG operates exclusively in the New Orleans, Louisiana metropolitan area.

The purpose of UMG is to pursue risk contracts in which providers accept capitated payments for health care services. UMG has two primary goals: (1) to gain and protect market share for its providers, and (2) to generate and distribute surpluses in the event that capitation payments received exceed the cost of health care services provided.

University Technology Group, LLC—LSUHN is the only member of University Technology Group, LLC ("UTG"). UTG was formed to participate in technology ventures that will assist LSUHN in the delivery of health care services or any other activities that will enhance LSUSHC's ability to carry out its medical, educational or research missions.

LSUHN Surgery Center LLC—LSUHN is the sole member of LSUHN Surgery Center LLC ("LSUHN SC"). LSUHN SC was formed to manage the day-to-day operations, including the billing and collection efforts, of the surgery center located at 2020 Gravier Street in New Orleans, Louisiana. LSUHN SC has not resumed activity since August 29, 2005, when Hurricane Katrina struck. It is unlikely that this entity will resume activity at its pre-storm location.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Estimates which are significant for LSUHN include contractual and bad debt allowances and the liability for medical claims payable. Accordingly, actual results could differ from those estimates.

Cash and Cash Equivalents—LSUHN considers all highly liquid investments in money market funds and investments available for current use with an initial maturity of three months or less to be cash equivalents. Amounts are recorded at fair value.

Short-Term Investments—At June 30, 2005, UMG held $2.3 million in an investment pool formed by UMG and other independent physician associations within the People's Health Network. The investment pool had the amounts on deposit in a cash account. The investment amount was available to UMG without restriction. During fiscal year 2006 this investment was liquidated and returned to the parent, LSUHN, in the form of a dividend.

Inventory of Drugs and Medical Supplies—Inventory at June 30, 2005, was stated at the lower of cost, determined by the first-in, first-out method, or market. The medical specialties requiring substantial inventories have not been reestablished since Hurricane Katrina in August 2005; accordingly, there are no material inventories at June 30, 2006.

Capital Assets—Capital assets are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line basis over the estimated useful lives of the assets, which range from 2-5 years. Assets held under capital lease obligations are recorded at the present value of the minimum lease payments and are included in equipment. Amortization of leased assets is included in depreciation and amortization expense.

Liability for Medical Claims Payable—The unpaid medical claims liability represents management's best estimate of the ultimate net cost of all reported and unreported claims incurred during the reporting period, including out-of-network claims. The estimate is based on actuarial projections of the historical development of claims incurred but not reported and case-basis estimates of claims reported prior to the end of the reporting period.

The estimate of the unpaid medical claims liability was based on the best data available to LSUHN; however, because of the limited number of members covered by LSUHN, the estimates are subject to a significant degree of inherent variability. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known; such adjustments are included in current operations.

Although management believes the estimate of the unpaid medical claims liability is reasonable under the circumstances, it is possible that LSUHN's actual incurred claims expense will not conform to the assumptions inherent in the determination of the liability; accordingly, the ultimate settlement of the claims may vary significantly from the estimate included in the accompanying financial statements.

Operating Versus Nonoperating Revenue and Expenses—LSUHN distinguishes operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services in connection with LSUHN's principal ongoing operations. The principal operating revenue of LSUHN is for patient services. Operating expenses include patient services expense, general and administrative expenses, supply and other expenses, and depreciation and amortization expenses. All revenue and expense not meeting this definition are reported as nonoperating revenue and expenses.

Patient Service Revenue Net of Contractual Adjustments and Allowances—LSUHN has agreements with third parties that provide for payments at amounts different from its established rates. Net patient service revenue is reported in the financial statements at the estimated net amounts realizable from patients, third-party payors, and others for services rendered. Major third-party payor arrangements include the Medicaid and Medicare programs.

LSUHN has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payments to LSUHN under these agreements includes prospectively determined rates per office visit and discounts from established charges.

Charity Care—LSUHN provides care to patients in the Louisiana public hospital system without regard to their ability to pay for those services. LSUHN does not pursue collection of charges generated from providing services to patients that are determined to qualify for charity care and as a result these charges are not reported as revenue. Because of the cost involved, LSUHN generally does not capture charges generated by free care activity in its billing system. However, in certain areas, the billing process requires that some free care charges be entered into the system before they are adjusted out of revenues. During the years ended June 30, 2006 and 2005, charity charges entered into the billing system and adjusted off were approximately $35,552,000 and $37,581,000, respectively.

Capitation Revenue—LSUHN receives capitated payments as compensation for a commitment to provide health care services to covered members. Capitation payments are recognized as revenue during the period in which LSUHN is obligated to provide health care services to these members.

Medical Claims Expense—LSUHN contracts with various physicians, physician groups, and other ancillary providers under the terms of Primary/Specialty Care Physician Agreements or other ancillary agreements for the purpose of providing health care services on behalf of LSUHN.

Based on the nature of the agreements, medical expense is recognized either during the period in which LSUHN is obligated to provide medical services for members or during the period in which medical services are incurred by members.

LSUHN participates in a catastrophic reserve pool with the other IPAs in the Network to provide shared-risk insurance coverage on physician charges between $10,000 and $12,500 per member per year. LSUHN has stop-loss insurance coverage with an unrelated insurer for charges in excess of $12,500 per member per year up to a maximum of $1,000,000 per member per year.

Income Taxes—LSUHN is a not-profit corporation organized under the laws of the state of Louisiana. It is exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code of 1986, and qualifies as a support organization, as defined in Section 501(a) of the Code.

Net Assets—LSUHN prepares its financial statements in accordance with Governmental Accounting Standards Board Statement ("GASBS") No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. It requires the classification of net assets into three components—invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

Invested in capital assets—net of related debt—This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

Restricted—This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

Unrestricted—This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

2. RELATED-PARTY TRANSACTIONS

LSUHSC provides certain clinical and administrative services as well as building space to LSUHN. Amounts paid for services provided under this arrangement were $9,454,036 and $18,009,621 during the years ended June 30, 2006 and 2005, respectively. As of June 30, 2006 and 2005, $12,674,727 and $5,799,564, respectively, was owed to LSUHSC for physician and non-physician services, including amounts accrued relating to accounts receivable.

LSUHN's affiliation agreement with LSUHSC requires LSUHN to pay at least ten percent (10%) of its annual gross cash receipts to LSUHSC, through the Medical School Enhancement Fund ("MSEF") to support the clinical, academic and research missions of LSUHSC. Cash payments totaling $8,786,484 and $8,450,558 were made to the MSEF during the fiscal years ended June 30, 2006 and 2005, respectively. As of June 30, 2006 and 2005, approximately $1,064,601 and $3,490,100, respectively, was due to LSUHSC for MSEF payments, including amounts accrued relating to accounts receivable.

During fiscal year 2005, a donation of $2,000,000 was made to the LSU Alumni Association to help finance the expansion of the learning center that is utilized by the medical students at LSUHSC. In fiscal year 2006, the Louisiana Legislative Auditor questioned the propriety of the donation, and although LSUHN disagrees with the Legislative Auditor's assessment, the donation was returned to LSUHN in 2006 at the request of the Chancellor of LSUHSC.

During the years ended June 30, 2006 and 2005, the LSUHSC Foundation made donations totaling $15,000 in 2006 and $30,000, respectively, to LSUHN to support the Musician's Clinic.

3. CAPITAL ASSETS

Capital asset activity for the fiscal years ended June 30, 2006 and 2005, was as follows:

	Balance June 30, 2005	Additions	Deletions	Balance June 30, 2006
Office furniture and fixtures	$ 1,076,863	$ 278,015	$ (951,074)	$ 403,804
Computers and related equipment	1,422,604	91,411	(523,118)	990,897
Medical equipment	1,591,996	286,160	(572,006)	1,306,150
Leasehold improvements	128,840	25,075	(84,954)	68,961
Total at historical cost	4,220,303	680,661	(2,131,152)	2,769,812
Less accumulated depreciation	(2,720,394)	(657,510)	1,838,470	(1,539,434)
Capital assets—net	$ 1,499,909	$ 23,151	$ (292,682)	$ 1,230,378

	Balance June 30, 2004	Additions	Deletions	Balance June 30, 2005
Office furniture and fixtures	$ 1,070,161	$ 66,528	$ (59,826)	$ 1,076,863
Computers and related equipment	1,191,247	231,357		1,422,604
Medical equipment	1,153,093	488,903	(50,000)	1,591,996
Leasehold improvements	128,840			128,840
Total at historical cost	3,543,341	786,788	(109,826)	4,220,303
Less accumulated depreciation	(2,222,443)	(589,208)	91,257	(2,720,394)
Capital assets—net	$ 1,320,898	$ 197,580	$ (18,569)	$ 1,499,909

4. OTHER ASSETS

UMG (see Note 1) invested $275,000 in New Orleans Regional Physician Hospital Organization, Inc. ("NORPHO") during the year ended June 30, 2000. NORPHO is responsible for pursuing contracts and third-party payors and for management functions such as financial services, medical management, claims management, member services, and provider relations for its hospital and independent physician association members, including UMG. UMG holds an approximate 10% interest in NORPHO and accounts for the investment under the cost method.

5. LEASE COMMITMENTS

LSUHN leases office space and equipment under operating leases that expire at various dates through 2009. Certain of the lease agreements provide for escalations based on cost of operations. Several locations where LSUHN rented medical or office space prior to the hurricane were not renewed either due to a lack of need or an inability to rent in the same location. Total rent expense for the years ended June 30, 2006 and 2005, was $163,077 and $1,179,009, respectively.

Minimum annual lease payments as of June 30, 2006, are as follows:

Years Ending June 30	
2007	$ 391,078
2008	124,464
2009	81,387
Total	$ 596,929

LSUHN leases certain medical equipment under three to five year capital lease agreements that include varying interest rates (5.82%–12.5%) and bargain purchase options. Future minimum lease payments under capital leases, together with the present value of net minimum lease payments as of June 30, 2006, are as follows:

Years Ending June 30	
2007	$ 69,271
2008	69,271
2009	69,271
2010	66,451
2011	41,131
Total minimum lease payments	315,395
Less amount representing interest	(38,669)
Present value of net minimum lease payments	276,726
Less current maturities	(55,804)
Leases payable—less current portion	$ 220,922

6. NOTES PAYABLE

Notes payable at June 30, 2006 and 2005, are as follows:

	2006	2005
Borrowings against revolving credit facility (Note 7)	$ -	$ 300,000
Note payable for equipment with interest at 7%, payable in monthly installments of $3,733 through November 2007, including interest, collateralized by the equipment	16,859	104,093
Less current maturities	(16,859)	(337,509)
Notes payable—less current portion	$ -	$ 66,584

7. CREDIT FACILITIES

On September 1, 2003, LSUHN SC entered into a $300,000 revolving credit facility with Chase secured by LHSHN SC's accounts receivable. The facility was paid in full and closed in June 2006. The interest rate was 5.6%. As of June 30, 2005, $300,000 had been drawn down.

8. 401(k) PLAN

In December 1997, LSUHN established a 401(k) plan for the benefit of its employees. The plan permits employees to contribute up to 15% of their compensation to the plan, subject to certain limitations. At its discretion, LSUHN may make contributions to the 401(k) plan for the benefit of participating employees. For the years ended June 30, 2006 and 2005, 401(k) plan expenses were $199,137 and $295,731, respectively.

9. CONCENTRATIONS OF CREDIT RISK

LSUHN provides services in New Orleans, Baton Rouge, and Lafayette. LSUHN grants credit to its patients, some of whom are insured under third-party payor agreements. LSUHN routinely obtains assignment of, or is otherwise entitled to receive patients' benefits from, Medicare, Medicaid and other third-party payors. The mix of receivables from its patients and third-party payors at June 30, 2006 and 2005, was as follows:

	2006	2005
Medicaid	37.4 %	30.8 %
Medicare	12.3	7.1
Commercial	24.0	18.1
Self pay	26.3	44.0
	100.0 %	100.0 %

LSUHN routinely invests available operating funds in highly liquid U.S. Government and agency obligations and money market mutual funds that generally invest in highly liquid U.S. government and agency obligations. Investments in money market funds are not insured or guaranteed by the U.S. Government; however, management believes the credit risk related to these investments is minimal.

10. INSURANCE COVERAGE

Malpractice Insurance—The physicians leased to LSUHN by LSUHSC are provided professional liability coverage by LSUHSC in accordance with the provisions of LA. R.S. 40:1299.39 et seq. for the services provided under the Cooperative Endeavor and Operating Agreements. These provisions provide the physician with coverage on malpractice claims up to $500,000 per occurrence, which is the limit on medical malpractice claims under current state law.

Self-Insurance—LSUHN was primarily self-insured for employee health insurance through April, 2003, at which time such benefits were transitioned to commercial insurance. At June 30, 2005, an accrued liability of $20,000 was carried for the run-off of claims incurred prior to April, 2003. During the year ended June 30, 2006, the $20,000 liability was fully liquidated. At June 30, 2006, there is no recorded liability for self-insurance.

11. GOVERNMENT REGULATIONS

The healthcare industry is subject to numerous laws and regulations of Federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, and government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Recently, government oversight has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. The office of the Inspector General of the Department of Health and Human Services has undertaken a project to audit Medicare billings of certain academic medical institutions. The government has stated that it believes that a significant amount of Medicare claims filed by teaching physicians are not properly documented as required by current interpretations of Medicare standards. If a provider is found to be in violation of these documentation standards, the government may require repayment of any overcharges and may impose a penalty of treble damages plus up to $10,000 per false claim. Management believes that LSUHN is in compliance with the fraud and abuse regulations as well as other applicable government laws and regulations, and with the Medicare documentation standards. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

Legislation and regulation at all levels of government have affected and are likely to continue to affect the operations of LSUHN. Federal healthcare reform legislation proposals debated in Congress in recent years have included proposals for the imposition of price controls and/or healthcare spending budgets or targets, significant reductions in Medicare and Medicaid program reimbursement to healthcare providers and the promotion of a restructured delivery and payment system focusing on competition among providers based on price and quality, managed care, and steep discounting or capitated payment arrangements with many, if not all, of LSUHN's principal payors. It is not possible at this time to determine the impact on LSUHN of government plans to reduce Medicare and Medicaid spending, government implementation of national and state healthcare reform or market-initiated delivery system and/or payment methodology changes. However, such changes could have an adverse impact on operating results and cash flows of LSUHN in future years.

12. SUBSEQUENT EVENT/CONTINGENT LIABILITY

In October 2006, LSUHN was named as a defendant in two lawsuits claiming wrongful death and damages resulting from the action of a physician leased by LSUHN from LSUHSC. The incidents occurred in a New Orleans hospital during the aftermath of Hurricane Katrina. LSUHN intends to vigorously defend itself and its representatives against these actions. At this time management is unable to determine with any certainty the settlement prospects or probability of success in either of these suits.

13. IMPAIRED CAPITAL ASSETS

During the fiscal year ended June 30, 2006, floodwaters from Hurricane Katrina destroyed the central control panel for the phone system at 2020 Gravier Street and certain medical and office equipment at LSUHN's urogynocology office at Lindy Boggs Hospital. A summary of the book value of the equipment lost and the insurance recoveries follows:

Book value of impaired medical and office equipment	$ (123,326)
Insurance recoveries	476,034
Net gain on impaired equipment	$ 352,708

Both the loss from the impairment from the equipment and the insurance recoveries are recorded in other income and expense in the Statement of Revenues, Expenses and Changes in Net Assets for the year ended June 30, 2006. There are no impaired assets carried on the books as of June 30, 2006.

14. NET PATIENT SERVICE REVENUE AND RECLASSIFICATION

Net patient service revenue for the years ended June 30, 2006 and 2005, was as follows:

	2006	2005
Gross patient service revenue:		
Billed revenue	$ 104,536,205	$ 185,151,429
Upper payment limits	7,865,860	
Total	112,402,065	185,151,429
Contractual adjustments	(32,400,488)	(79,943,822)
Free care	(35,551,534)	(37,581,100)
Provision for bad debts	(13,036,908)	(16,518,640)
Total	$ 31,413,135	$ 51,107,867

In 2005 and prior years, the Company reported net patient service revenue before consideration of the provision for bad debts, which amount was reported as an operating expense consistent with reporting practices prevalent in the healthcare industry. The American Institute of Certified Public Accountants issued guidance clarifying that the accounting standards promulgated by the Government Accounting Standards Board required that revenues be reported net of discounts and allowances; therefore, amounts previously reported separately as provision for bad debts should be reported as a component (i.e. reduction) of net patient service revenue. LSUHN adopted this method of reporting in 2006 and reclassified its presentation of the 2005 consolidated statement of revenues, expenses and changes in net assets to reduce net patient service revenue and operating expenses by $16,518,640, the amount of the provision for bad debts. This reclassification had no effect on the operating income, balance sheet or cash flows of LSUHN.

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED UPON AN AUDIT PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors of
Louisiana State University School of Medicine in
New Orleans Faculty Group Practice:

We have audited the financial statements of the Louisiana State University School of Medicine in New Orleans Faculty Group Practice, d/b/a LSU Healthcare Network and subsidiaries (a Louisiana non-profit corporation) ("LSUHN") as of and for the year ended June 30, 2006, and have issued our report thereon dated November 30, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered LSUHN's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether LSUHN's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards.*

This report is intended solely for the information and use of the Board of Directors, management and the Louisiana Legislative Auditor and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

November 30, 2006

Member of
Deloitte Touche Tohmatsu